THE PRESENT POSITION OF FOREIGN EXCHANGE.

[ABSTRACT.]

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To have prices stable both in space and in time has been the ideal implicit in all monetary development.

The pre-war system, centred upon London as the free market for gold where any credit might be drawn in gold, provided very effectively for stability in space and somewhat less effectively for stability in time. Its merits in the former respect had in the nineties been given a wider extension by the elaboration of the gold exchange system, steadying the rate of exchange between gold-using and silver- or paper-using countries. Improvement in point of stability in time was practicable by the organisation of the banks in each region around a central reserve bank, controlling the price of credit.

Incidentally the gold exchange system demonstrated that the internal circulation of gold was not essential to the adjustment of the purchasing power of a currency in stable relation with gold.

The pre-war system attained such adjustment of all currencies without any governmental or international machinery. Normal seasonal fluctuations were masked without risk by bankers' loans, abnormal strains offset by transfers of the international cash, gold bullion.

The fluctuations of purchasing power and of exchange rates consequent upon the abandonment of gold-convertibility and the cessation of adjustment in cash, have ruined the small investors of Europe and impose an onerous risk of fluctuating prices on all international trade. Stability both in time and in space has thus been lost. Even in gold-faithful countries, such as U.S.A. and Sweden, fluctuations in gold prices have been such as to undermine belief in the merits of gold-convertibility. American bankers have now an opportunity to repeat the work done in the 19th century by London, in finding the gold for a maximum area of markets using sound money.

Proposals for reconstruction take two main directions, one aiming at a renewal of the old stability in space, others at an improved stability in time. It is generally agreed that the exchanges can only be stabilised if the depreciated currencies of Europe are devalued and fresh mint-pars well within their resources are established as between them and the dollar. Deflation, the only sound alternative, would render the war-debt-service an intolerable burden, and, in any case, would mean prolonged depression and unemployment. The new mint-ratios would be administered on the gold-exchange plan of cashing notes into gold or foreign money only for the purpose of settling external indebtedness. There should at present be no restoration of gold to circulation in Europe. Economy of gold by this means might, however, produce a fresh depreciation of a degree similar to that of 1896-1914. To prevent any such fluctuations Irving Fisher, of Yale, has won considerable support for a scheme to stabilise purchasing power by making the gold value of the monetary unit rise or fall with an index-number of general prices, thereby automatically cancelling price-movements.

The proposal might achieve stability in time at the cost of upsetting that convertibility of all monies, termed stability in space, which is the great merit of the gold exchange system. In default of international action, this objection is fundamental. The aim of stability of value from year to year might be less rigid, but for that reason more safely realised by effective control of credit supplies through the central banks. This would call for no legislative tinkering with money. The machinery for its operation is already in existence.